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RUEAWJA/DEPT OF JUSTICE WASHDC IMMEDIATE

C O N F I D E N T I A L SECTION 01 OF 07 BEIJING 003856

SIPDIS

STATE FOR EAP/CM -- PARK AND FLATT
STATE FOR EEB/OIA -- SCHOLZ, TRACTON, AND HICKS
STATE FOR E - YON
STATE FOR L - CAPLAN
STATE PASS USTR FOR STRATFORD, WINTER, BAHAR
NSC FOR DNSA PRICE, SMART, AND LOI
TREASURY FOR TAIYA SMITH, RESNICK, AND SAMPLINER
COMMERCE FOR BRZYTWA AND ARONOFF

E.O. 12958: DECL: 09/28/2018

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SUBJECT: CORRECTED VERSION OF BEIJING 3855 -- Bilateral Investment
Treaty Negotiations: Deliberate Pace in First Round Due to MOFCOM
Staff Changes -- ELIMINATES GARBLED TEXT

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Classified By: Acting Economic Minister-Counselor Robert Forden for
Reasons 1.4 (b) and (d)

¶1. (C) SUMMARY: The United States and China held the first round of bilateral investment treaty (BIT) negotiations in Beijing, September 2-5, 2008. China concurred with the U.S. view that an agreement would be significant given the two countries' importance to the global economy as major investment destinations. At China's request, the U.S. delegation explained provisions in the U.S. proposed text and responded to detailed questions and comments from the Chinese side. Discussions were productive and business-like, but moved more slowly than expected. Chinese delegation members raised numerous questions and comments, but did not commit to formal positions. The United States and China subsequently agreed to a second round of negotiations the week of October 13, with the intention of completing the article-by-article review to facilitate preparation of a bracketed text.

¶2. (C) Comment: The methodical pace was likely due to: (i) the assignment of a new Chinese lead negotiator, new Ministry of Commerce (MOFCOM) Treaty and Law Department Director General (DG) Li Ling, who had not participated in previous exploratory discussions; (ii) the large number of new Chinese participants; and (iii) former lead negotiator Guo Jingyi's detention for alleged corruption in the approval of foreign investment, which clearly had shocked some of his former staff members and may have led China's negotiators to proceed with special caution. Working in our favor, the number and quality of questions and the size of the Chinese delegation suggests China's sincere desire to understand the U.S. text, suggesting it may be prepared to use the U.S. text as the basis for line-by-line negotiations. End Summary and Comment.

OPENING REMARKS

¶3. (C) Director General Li opened by welcoming the U.S. delegation to Beijing and commenting that the large number of Chinese ministries represented demonstrated the PRC's commitment to the BIT

negotiations. There were as many as 30 Chinese officials present at times, representing a wide range of ministries, as outlined at the end of this cable. DG Li recalled past efforts to negotiate a United States-China BIT, noting she had participated in the failed BIT talks of the 1980s. According to Li, during the BIT exploratory talks held between January 2007 and June 2008, significant differences in approach were identified in the areas of national treatment, free transfers, performance requirements, expropriation, minimum standard of treatment, transparency, environment and labor, financial services, tax, and investor-State dispute settlement. A BIT would facilitate bilateral investment in each country, but we need to recognize the gap in the level of economic development between the two countries. Li recalled that the United States and China failed to reach agreement in the 1980s because the USG insisted on a "high standard" BIT and ultimately judged that no agreement was better than a bad agreement. Li noted that China has entered into more than a hundred BITs, which have played important roles even where they have not provided such high standards. Li emphasized that the BIT would need to reflect China's current level of development and that the BIT negotiations would be a "protracted, uphill battle" for both sides.

14. (C) The U.S. delegation responded that, while BIT talks in the 1980s were not fruitful, significant developments in each economy should assist our joint efforts to find common ground. Any agreement would need to be perceived as high-standard by each side given its respective interests. The U.S. delegation agreed generally with Li's list of BIT issues where differences exist but stressed that the extent of differences between the two sides varies significantly from issue to issue. Some of the issues represent very significant differences in approach (e.g., national treatment). On a number of other issues, however, the differences are less substantial, and, in some areas, the two sides have discussed potential means to narrow differences. The U.S. delegation also noted that, in many instances, the purpose of added detail in the U.S. text is to clarify the

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meaning of provisions or to respect the interests of government regulators in sensitive sectors; thus while our texts differ, our interests are likely to converge.

15. (C) U.S. delegation co-lead Wes Scholz added that international investors and foreign governments were paying attention to the evolution of the U.S. China investment relationship. Developments in the U.S. and China suggest a convergence of interest that has substantially increased the likelihood of finding common ground in BIT negotiations. Nevertheless, there are significant challenges that will require working-level and political-level engagement to succeed. Scholz noted the two countries' leaders have expressed the hope that we make significant progress before SED V in December. This goal takes on particular importance for the United States given our political calendar and our desire to ensure that, if negotiations need to continue under a new Administration, there is a compelling case to continue without significant delay. U.S. delegation co-lead Daniel Bahar explained that the U.S.-tabled text reflect U.S. views on all key issues. He recalled earlier agreement with the Chinese delegation that the two sides should work toward a bracketed text illustrating all areas of commonality and difference. The development of negotiating positions and the consolidated bracketed text should benefit from the progress made in the detailed 17-months of BIT exploratory discussions between the two sides.

REVIEW OF U.S. TEXT

PREAMBLE

16. (C) The U.S. delegation provided an overview of the preamble of its proposed text, which sets out the objectives of the Parties in entering into the treaty. The Chinese delegation took issue with language about the Parties recognizing that agreement will stimulate the flow of "private capital," asserting that this language does not account for state-owned capital, which is important to China. The Chinese delegation also questioned the appropriateness of language expressing the desire to achieve the objectives of the treaty in a

manner consistent with protecting the "environment," and "promotion of internationally recognized labor rights." Members of the Chinese delegation suggested that these issues are best addressed in other fora.

¶17. (C) The U.S. delegation noted that, notwithstanding the reference to "private capital" in the preamble, the U.S. proposed text also applies to and protects state-owned capital. The references to labor and environment are intended to emphasize the compatibility of these interests with the protection of investment, and relate to specific articles in the draft BIT text (Arts. 12-13), which address these issues in only limited ways. None of these provisions seeks to use the BIT as a means to address how each Party regulates these issues more broadly, but the proposed references are important to stakeholders on the U.S. side.

DEFINITIONS (ARTICLE 1)

¶18. (C) The Chinese delegation raised questions or comments on all of the significant definitions and showed particular sensitivity towards references to state enterprises. (Note: China encourages its largest firms, including state-owned enterprises, to invest abroad because it believes they have the best capacity to evaluate and manage overseas investment projects. End Note.). They also questioned the necessity of some definitions that they perceive as "obvious" (e.g., "non-disputing Party," "TRIPS Agreement," "UNCITRAL," and "WTO Agreement"), as well as the appropriateness of the definition of "state enterprises," while noting that some other terms should be defined, such as "returns." (Note: Many Chinese BITs use the term "returns" in the transfers article and define the term; however, U.S. BITs do not use the term "returns" except as part of a separate term, "returns in kind.")

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¶19. (C) On the definition of "enterprise," the Chinese suggested that it refer to any entity constituted under the laws of each Party. They then asked how various types of arrangements such as "joint ventures" and "trusts" are defined under U.S. law. The U.S. delegation responded that these matters are governed primarily by state law, and that the definition is intended to be flexible enough to take account of forms of enterprises that evolve over time or are expressed differently in different legal systems. China also expressed concern over the inclusion of a "branch" within the broader definition of the term "enterprise," noting that a branch may not bring a claim in Chinese domestic courts. (Note: China restricts foreign investment in some sectors to the establishment of branches, particularly legal and financial services. End Note.)

¶10. (C) Regarding the definition of "investment," China asked why the U.S. model does not include a reference to investments "made in accordance with a Party's law." (Note: In the exploratory talks, China asserted that this language might provide a means of qualifying the BIT's substantive obligations such as MFN.) The U.S. delegation explained its view that such language is not necessary and could create unnecessary ambiguity. China raised several other questions (e.g., overlap between "concession contracts" and "licenses [and] authorizations conferred pursuant to domestic law," and the need for including an "enterprise" as an example of the form that an investment may take). The U.S. side stressed, in response, the broad definition of investment, which is intended to cover all forms of investment.

¶11. (C) China also raised questions about the terms "investment agreement" and "investment authorization," and how these definitions relate to authorizations or approvals under Chinese law that may not fit into either definition. In response to questions from the Chinese side, the U.S. delegation explained that the United States does not have an "investment authority" (i.e., a single, broad based screening mechanism for all inbound foreign investment); with respect to China, the U.S. side said that it would need to consider further whether China has such an authority as defined in the BIT.

¶12. (C) In the definition of "investor of a Party," China asked why a Party should be included in this definition. China also raised

questions about the language stating that, in the case of a dual national, the individual is deemed to have the nationality of the person's "dominant and effective nationality." When an MFA representative asked about the applicable criteria and asked whether a separate convention on diplomatic relations between the two countries would prevail, the USG explained that this definition requires a fact-intensive inquiry based on a principle of customary international law. On the definition of "national," China asked how the USG distinguishes between "citizens" and "nationals" under its law. The U.S. delegation committed to provide a detailed response at a later time.

SCOPE AND COVERAGE (ARTICLE 2)

¶13. (C) China expressed concern that the Articles on Performance Requirements, Investment and Environment, and Investment and Labor apply to "all" investments in the territory of a Party (as opposed to just investments/investors of the other Party), noting concern that the obligation might confer benefits on third countries. The U.S. delegation explained that the BIT does not confer dispute settlement or other legal rights on investors of third-countries. Rather, the three obligations apply to all investments - including investments of third-country and domestic investors - in order to give full effect to the obligations as between the Parties. Citing performance requirements as an example, the U.S. delegation explained that investors of either Party could be placed at a competitive disadvantage or otherwise harmed if the treaty obligation did not apply with respect to all investments.

¶14. (C) China questioned whether a Scope and Coverage article (not present in China's BITs) is self-evident and thus unnecessary. The

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U.S. delegation explained that this provision is in fact necessary. For example, the language providing that the treaty's scope is limited to measures by a Party "relating to" investors and investments indicates that a legally significant relationship must exist between the government action and the investor or investment in question. China also asked for an example of a U.S. entity that exercises "delegated government authority." The U.S. delegation cited the Pennsylvania Avenue Development Corporation and the Tennessee Valley Authority.

¶15. (C) In the provision stating that the BIT does not apply to any "act or fact" that preceded the BIT's entry into force, China suggested that this term should be defined and questioned how it differs from the separate definition of "measure." In response, the U.S. delegation stressed that this language is intended to track the comparable provision in the Vienna Convention on the Law of Treaties. China also asked for clarification of the term "political subdivisions." The U.S. delegation replied that this term encompasses all levels of government below the central / national level.

MOST-FAVORED-NATION TREATMENT (ARTICLE 4)

¶16. (C) Li said that China shares the same general view as the USG on the Most-Favored-Nation (MFN) treatment provision. However, she raised concern about extending the obligation to the "pre-establishment" phase of investment" and about the reference to "covered investments" (a definition that China had asserted was unnecessary during the discussion of Article 1). Li said that footnote 9 (which clarifies that a Party is required to provide the "better of" national treatment and most-favored-treatment) is acceptable, citing such a provision in China's BITs; she said footnote 8 (clarifying that the MFN provision does not encompass BIT dispute resolution mechanisms) is a new concept that China will need to consider further. Li suggested that China could agree to MFN at the pre-establishment phase if the United States would not demand pre-establishment coverage for the national treatment obligation. The U.S. delegation welcomed China's general agreement on the principles of the MFN obligation, but pushed back strongly on Li's attempt to link MFN pre-establishment to national treatment pre-establishment coverage. Given China's generally broad approach

to MFN in other contexts, such as the Finland-China BIT, the recent New Zealand-China free trade agreement investment chapter, and the GATS, the U.S. side argued that the MFN issue should be much simpler to resolve.

MINIMUM STANDARD OF TREATMENT (ARTICLE 5)

¶17. (C) In introducing its proposed minimum standard of treatment provision, the U.S. delegation explained that this provision was one of those provisions substantially revised in the 2004 U.S. model BIT.

The U.S. experience with other investment agreements caused us to re-think our approach on the minimum standard of treatment provision in order to provide significantly greater specificity than the broad language found in earlier agreements (e.g., replacing short-hand references to "fair and equitable treatment" with more specific rules tied to the customary international law minimum standard of treatment of aliens).

¶18. (C) The Chinese delegation pointed out that its existing BITs generally contain a much shorter, simpler iteration of this provision and asked questions about the content of the U.S. obligation. In response to China's questions, the U.S. delegation explained that customary international law results from the general and consistent practice of states over time, that it is a widely-accepted concept as reflected in the Statute of the International Court of Justice, and that a representative from MFA had referred to the same concept at several points earlier in the discussion. When asked about examples of principles covered by this obligation, the U.S. delegation cited two examples listed in Article 5 (i.e., the obligation not to deny justice and the obligation to provide full protection and security).

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The MFA representative asserted that the first sentence of the U.S. Annex A is a correct definition of customary international law, while the second (which refers to Article 5 covering all customary international law principles that protect the economic rights and interest of aliens) is not. The U.S. delegation also clarified the reference to the "principle of due process embodied in the principal legal systems of the world." The U.S. sought China's agreement on the desirability, in principle, of constraining subjective decision-making on the part of arbitrators when considering this provision. China said it would need to consider these issues further and noted that significant differences of approach remain.

¶19. (C) The Chinese noted that paragraphs 4 and 5 of Article 5, relating to armed conflict and civil strife, address different issues than the rest of Article 5, and seem to cover more particular circumstances than the expropriation article. They therefore suggested that they could include these paragraphs if they were included as a separate article. The U.S. delegation responded that because there would be no legal difference between the meaning of these paragraphs if included in Article 5 or a separate article, we could consider their request.

EXPROPRIATION AND COMPENSATION (ARTICLE 6)

¶20. (C) The U.S. delegation provided an overview of the article on Expropriation and Compensation, which provides that a Party may expropriate property only in accordance with certain conditions, including the payment of prompt, adequate, and effective compensation; for a public purpose; and in accordance with due process of law. The Chinese delegation sought clarification of the meaning of the concept "public purpose" and how this term differs from the concept of "public interest"; how compensation at "fair market value" is determined; and the meaning of "due process" in context of expropriation. The Chinese delegation explained that there are significant differences between the standard set out in Article 5 and the standard for compensation in the event of an expropriation pursuant to China's constitution (Articles 10, 13). They did not identify any substantive (as opposed to drafting) differences, however. They noted that under China's constitution and its Property Law (Article 42), the government will compensate investors for expropriated property in accordance with "law," which refers to Chinese laws and regulations. The U.S. delegation

responded that our federal and state constitutions deal with compensation for expropriation in a similar way, but we have never viewed the BIT language to conflict with our domestic law.

NEXT STEPS

¶21. (SBU) The U.S. delegation proposed that the next round of negotiations focus on completing the article-by-article review of the U.S. proposed text, in the hope that achieving this objective would give the Chinese delegation the information it needs to undertake internal consultations and provide its official positions on each issue. The U.S. delegation noted that both sides have a mandate to make significant progress before the next SED meeting in early December. Li commented that the three and a half days of discussions were fruitful and constructive. The initial talks had assisted the Chinese side in gaining a better understanding of the U.S. proposed provisions, which will be useful in understanding areas of commonality and difference as the negotiations proceed. In subsequent discussions, the two sides agreed to hold the second round of negotiations the week of October 13 in Beijing for four or five days.

¶22. (U) The U.S. delegation has cleared this cable.

¶23. (U) Chinese Delegation List:

--MOFCOM--

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LI Ling, Treaty and Law, DG, Chief negotiator
WEN Xiantao, Treaty and Law, Director
CHEN Ran, Treaty and Law official
XUE Xiaohong, Treaty and Law official
WANG Hongbo, American Department, Business Counselor
WANG Youli, American Department, Second Secretary
SUN Peng, FDI Department, DDG
JI Xiaofeng, FDI Department, Director

--MFA--

SUN Jin, Treaty and Law, Director
LI Tingting, Second Secretary

--NDRC--

YUAN Feng, Outward and Inward Investment officer

--MIIT--

WANG Jianzhong, Programming Department, Deputy Director
JIA Hongwei, Industrial Policy Department, Deputy Director rank
ZHANG Xiaoyan, International Cooperation Department, Deputy Director

--MOF--

ZHANG Chenglong, Taxation Department Director
LIN Xuebing, Taxation Department, Deputy Director
FANG Xia, Tariff Department, Director
WANG Shaoshuang, Treasury Department
Director
ZHOU Yong, Treasury Department, Deputy Director

--OTHER MINISTRY REPRESENTATIVES--

ZHANG Lu, MOHRSS, Int'l Cooperation Department, Dep. Director
QUAN Bei, PBOC, Int'l Cooperation Dept., Deputy Director
ZHU Hong, PBOC, Treaty and Law Dept., Director
WANG Lixiao, SASAC, Policy and Law Bureau, Director
ZHOU Huaishi, SAT, Int'l Taxation Dept., Deputy Director
ZHANG Jianhui, SCLAO, Industry Transport and Commerce, Deputy Director
BAI Ruiming, CBRC, Supervision Department III, Director
XIANG Chunsheng, CSRC, International Department, Deputy Director
LIU Zhifu, CIRC, International Department, Deputy Director

CAI Qiusheng, SAFE, Capital Department, Director

124. (U) U.S. Delegation List

--STATE--

Wesley S. Scholz, Office Director, Office of Investment Affairs
Michael Tracton, Bilateral Investment Treaty Coordinator, Office of
Investment Affairs
Lee Caplan, Attorney-Adviser, Office of the Legal Adviser
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--USTR--

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Audrey Winter, Deputy Assistant USTR for China Affairs, Office of
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--COMMERCE--

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Arthur Aronoff, Senior Counsel, Office of the Chief Counsel for
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--TREASURY--

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Bonnie Resnick, International Economist, Office of International
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Gary Sampliner, Senior Counsel, Office of the General Counsel

--U.S. EMBASSY--

Robert Luke, Minister-Counselor for Economic Affairs
Matthew Dolbow, First Secretary for Economic Affairs

PICCUTA